BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

In the matter of:	
Federal-State Joint Board on Universal Service	CC Docket No.96-45 DA 02-2976

COMMENTS OF THE CALIFORNIA PUBLIC UTILITIES COMMISSION AND OF THE PEOPLE OF THE STATE OF CALIFORNIA

Pursuant to Public Notice DA 02-2976 in the above-referenced docket ("*Public Notice*"), the People of the State of California and the California Public Utilities Commission ("California" or "CPUC") hereby file these comments on the Recommended Decision of the Federal-State Joint Board on Universal Service ("Joint Board"), adopted October 15, 2002 ("*Recommended Decision*").[1] In the *Public Notice*, the Federal Communications Commission (FCC or Commission) seeks comment on the Joint Board's recommendations on issues from the *Ninth Report and Order*[2] that were remanded to the Commission by the United States Court of Appeals for the Tenth Circuit.[3] The court determined that the Commission did not provide an adequate explanation for its decision that the federal high-cost universal service support

[1] Federal-State Joint Board on Universal Service, CC Docket No. 96-45, *Recommended Decision*, FCC 02J-2, (Jt. Bd. rel. October 16, 2002) (*Recommended Decision*).

[2] Federal-State Joint Board on Universal Service, CC Docket No. 96-45, Ninth Report and Order and Eighteenth Order on Reconsideration, 14 FCC Rcd 20432 (1999) (*Ninth Report and Order*) *remanded, Qwest Corp. v. FCC*, 258 F.3d 1191 (10th Cir. 2001).

mechanism for non-rural carriers achieved the statutory principles codified in section 254 of the Act.[4] Specifically, the court stated that the Commission did not: (1) define adequately the key statutory terms "reasonably comparable" and "sufficient"; (2) adequately explain setting the funding benchmark at 135% of the national average; (3) provide inducements for state universal service mechanisms; or (4) explain how this funding mechanism will interact with other universal service programs.[5]

In the Recommended Decision, the Joint Board recommends a mechanism that includes: (1) continuing use of a national average cost benchmark based on 135% of the national average cost; (2) funding 76% of state average costs exceeding the national benchmark; (3) establishing a national rate benchmark based on a percentage of the national average urban rate; (4) implementing state review and certification of rate comparability; and (5) providing states the opportunity to demonstrate that further federal action is needed because current federal support and state actions together are insufficient to yield reasonably comparable rates.[6] [7]

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[3] *Qwest Corp. v. FCC*, 258 F.3d at 1202.

[4] *Qwest Corp. v. FCC*, 258 F.3d at 1202.

[5] *Qwest Corp. v. FCC*, 258 F.3d at 1201.

[6] *Recommended Decision*, FCC 02J-2, at 7, (Jt. Bd. rel. October 16, 2002).

[7] We note that the Commission reserved review of the fourth issue on remand for the reason that a response to the remanded issues relating directly to the non-rural mechanism and a critical examination of the mechanism should be completed prior to a comprehensive review of the rural and non-rural universal service support mechanisms. See Federal-State Joint Board on Universal Service, CC Docket No. 96-45, *Notice of Proposed Rulemaking and Order*, 17 FCC Rcd 2999, 3010-11, paras. 25-26 (*Remand Notice*).

In general, California agrees with the Joint Board's recommendations and believes that they sufficiently satisfy the Tenth Circuit remand. However, California opposes any additional "targeted" support based on a supplemental rate mechanism.

I. BACKGROUND

The *Ninth Report and Order* established a federal high-cost universal service support mechanism for non-rural carriers based on forward-looking economic costs. The forward-looking mechanism determines the amount of federal support to be provided to non-rural carriers in each state by comparing the statewide average cost per line for non-rural carriers, as estimated by the Commission's cost model, to a nationwide cost benchmark. Determining the amount of money a state receives is a two-step process. First, by its cost model, the Commission set a benchmark of 135% of the national average cost per line.[8] Second, the Commission computes the average cost per line within a state. If the statewide average cost exceeds the 135% benchmark, the FCC will provide funding for costs in excess of the benchmark.[9] Any support given to a state is generally distributed directly to the carriers. The funding is targeted based on the costs at the wire-center level, with each carrier receiving its proportionate share, although a state may ask that the targeting rules be waived.[10] In order to receive funding, the state must certify that a carrier is using funding appropriately.[11]

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[8] This average, as well as the statewide average is of lines served by only non-rural carriers.

[9] Currently, this support is only for 76% of costs exceeding the benchmark, because interstate access rates already subsidize on average 24% of these costs. *Ninth Report and Order*, 258 F.3d at 63.

[10] *Ninth Report and Order*, 14 FCC Rcd at 20472, para. 73.

[11] *Ninth Report and Order*, 14 FCC Rcd at 20482-20483, para. 95.

In the *Ninth Report and Order*, the Commission adopted the Joint Board's recommendation to use costs as a proxy for rates in assessing its responsibilities to enable the reasonable comparability of rates. In addition, the Commission found that statewide averaging was most consistent with the federal role of providing support for intrastate universal service to enable the states to ensure reasonable comparability of rates.[12]

The Tenth Circuit in *Qwest v. FCC* observed that the Commission must base its universal service policies on the principles listed in section 254(b). The court found two principles in section 254(b) most relevant here. First, section 254(b)(3) provides: "Access in rural and high cost areas. Consumers in all regions of the Nation, including low-income consumers and those in rural, insular, and high cost areas, should have access to telecommunications and information services, including interexchange services and advanced telecommunications and information services, that are reasonably comparable to those services provided in urban areas and that are available at rates that are reasonably comparable to rates charged for similar services in urban areas."[13] Also, the court found relevant section 254(b)(5) which provides that "there should be specific, predictable and sufficient Federal and State mechanisms to preserve and advance universal service." The court also noted section 254(e), which states any federal support for universal service "should be explicit and sufficient to achieve the purposes of this section."[14]

[12] *Ninth Report and Order*, 14 FCC Rcd at 20457, para. 45.

[13] 47 U.S.C. section 254(b)(3).

[14] 47 U.S.C. section 254(e).

The court determined that the Commission did not provide an adequate explanation for its decision that the federal high-cost universal service support mechanism for non-rural carriers achieved the statutory principles codified in section 254 of the Act.[15] The court stated that the Commission did not: (1) define adequately the key statutory terms "reasonably comparable" and "sufficient"; (2) adequately explain setting the funding benchmark at 135% of the national average; (3) provide inducements for state universal service mechanisms; or (4) explain how this funding mechanism will interact with other universal service programs.[16]

II. DISCUSSION

A. CALIFORNIA IS GENERALLY SUPPORTIVE OF THE JOINT BOARD'S RECOMMENDED DECISION.

As recognized by both Congress and the Commission, the purpose of universal service is to ensure that primarily residential customers have access to affordable telephone service. California agrees with those Joint Board recommendations that equitably balance consumer interests in those states that are contributors to, and in those states that are recipients of, federal funding. As we have stated in previous comments, California agrees with the Commission that a mechanism that produces a federal universal service fund at or near the existing level produces affordable rates, balances the interests of contributor and recipient states, and therefore satisfies the goal of universal service.

[15] *Qwest Corp. v. FCC*, 258 F.3d at 1202.

[16] *Qwest Corp. v. FCC*, 258 F.3d at 1201.

In comments filed previously with the Commission, California has indicated its support for a federal universal service methodology for funding high cost areas that embodies seven principles: (1) the methodology uses forward-looking costs to determine high cost support; (2) federal high cost support is narrowly targeted to truly high cost areas throughout the nation; (3) the federal high cost support fund is modestly sized; (4) the methodology minimizes the burden on those that contribute to it, and reduces distortions in the marketplace caused by such methodology; (5) contributions to the federal high cost fund are based solely on assessing interstate revenues; (6) recovery of federal charges for the high cost fund is only from interstate rates; and (7) the methodology for determining the level of high cost support is administratively simple to use and apply. All of these principles are consistent with the Telecommunications Act of 1996 ("1996 Act" or "Act").

California is pleased that the Joint Board's Recommended Decision, which continues the use of a federal high-cost universal service support mechanism for non-rural carriers based on forward-looking economic costs, advances a number of these fundamental principles and policies. However, the Joint Board makes one recommendation that would undermine its goal of limiting the size of the federal fund. The Joint Board recommends a proposed supplemental rate mechanism to give states further federal funding. This rate-based mechanism is contrary to the Commission's own rationale for having a cost-based support system. Moreover, it is unnecessary because the existing 135% cost based benchmark is sufficient. California also finds the

supplemental rate mechanism would be unworkable, an administrative burden for the Commission, states, and carriers, and would create the potential for endless litigation.

B. THE JOINT BOARD SUFFICIENTLY JUSTIFIES SETTING THE FUNDING BENCHMARK AT 135% OF THE NATIONAL AVERAGE.

The Joint Board recommends continuing use of a national average cost benchmark based on 135% of the national average cost. The Tenth Circuit stated that the Commission did not adequately explain setting the funding benchmark at 135% of the national average. However, the Tenth Circuit also stated that if the 135% benchmark actually produces urban and rural rates that are reasonably comparable, however those terms are defined, the court would uphold the mechanism.

In the Recommended Decision, the Joint Board agrees with Verizon that "reasonably comparable" in the context of section 254(b) means that federal support be sufficient to *maintain* the range of rates existing at the time the 1996 Act was adopted. The Joint Board contends that in adopting section 254, Congress was not directing the Commission to implement a mechanism to adjust rates, but rather was trying to prevent competition from eroding implicit subsidies suitable for a monopoly environment. The Joint Board agrees with Verizon that the 135% benchmark is consistent with Congressional intent that federal support be sufficient to maintain the range of rates existing at the time the 1996 Act was adopted. In addition, the Joint Board and Commission have previously determined that current rates are generally affordable.[17]

[17] *Seventh Report and Order*, 14 FCC Rcd at 8092, para. 30; *First Report and Order*, 12 FCC Rcd at 8780-1, para. 2; *Second Recommended Decision*, 13 FCC Rcd at 24746, para. 3; Federal-State Joint Board

The Commission interpreted the goal of maintaining a "fair range" of rates to mean that support levels must be sufficient to prevent pressure from high costs and the development of competition from causing unreasonable increases in rates above current affordable levels."[18]

The Joint Board explains that the General Accounting Office (GAO) Report[19] shows that the 135% benchmark produces urban and rural rates that are reasonably comparable. The GAO Report demonstrates that six years after passage of the Act the national averages of rural, suburban, and urban rates for residential customers diverge by less than two percent.[20] Moreover, the Joint Board finds that a cluster analysis and a standard deviation analysis support the 135% benchmark.[21]

Since rates have not changed substantially since 1996, the 135% benchmark appears to fulfill the goals of section 254. With the GAO Report, standard deviation analysis, and cluster analysis, the Joint Board has addressed the relevant data and provided adequate record support and reasoning for the 135% benchmark. The Joint-Board has made a rational and informed decision on the record before it in order to achieve the principles set by Congress.

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on Universal Service, *Recommended Decision*, 12 FCC RCd 87, 154. para. 133 (Jt. Bd. 1996) (*First Recommended Decision*).

[18] *Id*.

[19] United States General Accounting Office, *Telecommunications: Federal and State Universal Service Programs and Challenges to Funding* (GAO-02-187, Feb. 4, 2002) (*GAO Report*).

[20] *Recommended Decision*, FCC 02J-2, (Jt. Bd. rel. October 16, 2002), par 34, citing Letter from W. Scott Randolph, Director – Regulatory Affairs for Verizon Communications, to Marlene H. Dortch, Federal Communications Commission, dated June 26, 2002 (Verizon June 26 *ex parte*).

[21] *Recommended Decision*, FCC 02J-2, (Jt. Bd. rel. October 16, 2002), paras. 34-38.

Certain parties have suggested that the 135% benchmark be lowered. This proposal would significantly inflate the size of the federal fund beyond its current level. While such a proposal would benefit certain non-urban states, it requires large, urban states, like California and New York, to subsidize other states in amounts well in excess of their current contributions to the federal fund. In light of the GAO Report, standard deviation analysis, and cluster analysis, lowering the 135% benchmark would be excessive, produce inequitable results, and should not be adopted.

In addition, we also agree with the Joint Board's recommendation that the Commission continue to use a nationwide cost benchmark rather than an urban benchmark. The *urban* benchmark would compare statewide average costs to an average nationwide urban benchmark. The goal of the Commission is to provide federal support based on costs that permit states to set *reasonably comparable* urban and rural rates. Reasonably comparable urban and rural rates have been determined to be the range of rates existing at the time the 1996 Act was adopted. As Commissioner Abernathy correctly concluded, the goal of the Act is not to set rural rates down to the lower-than-average urban rates. The GAO study supports that current rural and urban rates were not much different under the existing universal service support structure. Therefore, there is no need to change the benchmark so fundamentally by basing it on an urban benchmark.

Moreover, a nationwide urban benchmark should be rejected because it would significantly inflate the universal service fund and upset the current reasonable comparability between urban and rural rates. If the Commission were to base a benchmark on urban rather than nationwide average costs, the percentage benchmark

would have to be increased above 135% in order to maintain the existing comparability between urban and rural rates. Finally, as we have stated in previous comments, modifications to the federal high cost mechanism for non-rural carriers are precedential. The decisions made in this proceeding will have compounding effects when applied to rural carriers.

C. A NATIONAL RATE BENCHMARK MAY BE USED FOR STATE CERTIFICATION BUT NOT FOR ADDITIONAL FEDERAL SUPPORT FOR A STATE.

The court stated that the Commission did not define adequately the key statutory term "reasonably comparable" or provide inducements for state universal service mechanisms.

To fulfill these requirements, the Joint Board, in general, recommends that the Commission require states to certify that their rates are reasonably comparable or provide reasons as to why they are not, and give states the opportunity to demonstrate that further federal action is needed because current federal support and state action together are insufficient to achieve reasonably comparable rates.

Specifically, the Joint Board recommends the Commission expand the current annual certification process under Section 254(e) of the Act to require states to certify that the basic service rates in high-cost areas served by eligible telecommunications carriers (ETCs) within the state are reasonably comparable to a national rate benchmark. The Joint Board recommends that the Commission establish a "safe harbor" whereby a state whose rates are at or below a certain rate benchmark may certify that their basic service rates in high-cost areas are reasonably comparable without having to submit rate

information. States have the option of submitting additional data to demonstrate that other factors affect the comparability of their rates. For example, states may demonstrate that additional services are included in the basic service rate or that the method in which the state has targeted existing universal service support is different, and that the rates above the benchmark actually should be presumed reasonably comparable. If a state's rates are more than the rate benchmark, the state could request further federal action based on a showing that federal support and state actions together were not sufficient to yield reasonably comparable basic service rates statewide. Further federal actions could include, but are not limited to, additional targeted federal support, or actions to modify calling scopes or improve quality of service where state commissions have limited jurisdiction. A state requesting further federal action must show that it has already taken all actions reasonably possible, and used all available state and federal resources to make basic service rates reasonably comparable, but that rates nevertheless fall above the benchmark. A state whose basic service rates exceed the rate benchmark and that requests further federal action should be required to submit rate data in support of its certification, based on a basic service rate template.[22]

California does not object to the Joint Board's proposal to require states to certify that the basic service rates in high-cost areas served by eligible telecommunications carriers (ETCs) within the state are reasonably comparable to a national rate benchmark. California believes this is one way for the Commission to fulfill the Tenth Circuit's

[22] *Recommended Decision*, FCC 02J-2, (Jt. Bd. rel. October 16, 2002), para. 50.

request to induce states to fulfill their own obligations to ensure reasonable comparability between urban and rural areas.

However, California opposes the proposal that states be invited to make individualized showings that additional "targeted" support based on a comparison of rates is warranted and that a rate benchmark of 135% of the average urban rate may be appropriate for making that comparison. California opposes *any* supplemental rate mechanism to be used for further federal support.

The national rate benchmark as mentioned in the Joint Board's proposal is appropriate *only* as a "safe harbor" with regard to further federal support. The national rate benchmark should *not* be used as a mechanism for a state to obtain additional "targeted" support.

First of all, a rate-based mechanism is contrary to the Commission's own rationale for having a cost-based support system. The Commission has already agreed that the cost analysis as a proxy for rate analysis is the best approach. The Commission has stated at length reasons why rate comparisons among states are inherently flawed. In the *Second Recommended Decision*, the Joint Board recommended that, because rate setting methods and goals may vary across jurisdictions, the Commission, "use the cost of providing all supported services, rather than local rates" to determine high-cost federal support.[23] In the *Seventh Report and Order*, the Commission stated "state rate designs may reflect a broad array of policy choices that affect local rates, including implicit intrastate subsidies,

[23] *Second Recommended Decision*, 13 FCC Rcd at 24754, para. 19.

enhanced service and other intrastate services."[24] In the *Ninth Report and Order*, the Commission correctly adopted the Joint Board's recommendation to use costs as a proxy for rates. The Commission concluded that comparing costs in different states, rather than rates, would allow the federal mechanism to provide sufficient support to enable reasonably comparable rates without having to evaluate the myriad state policy choices that affect those rates.[25] Moreover, the Tenth Circuit in *Qwest* noted that the petitioners do not challenge the use of costs as a proxy for rates.[26]

In the *Recommended Decision*, the Joint Board reaffirmed the reasons that costs should be used instead of rates. The Joint Board acknowledged that states may base rates on numerous considerations in addition to cost. For example, local rates may vary from state to state depending on each state's local rate design policies; whether or not a carrier's rates are set based on a price cap approach; the degree to which implicit subsidies may remain within local rates; whether a state universal service fund exists; and other factors. The Joint Board correctly concluded that the lack of uniformity in local rate design practices could lead to inequitable treatment between states with substantially similar costs but different local rate policies. The Joint Board affirmed that the use of costs rather than rates to determine federal support was central to the *Ninth Report and Order*. Morever, as State Commissioner Thomas Dunleavy properly stated, one of the biggest problems with rate comparisons among states is normalizing rates for the varying

[24] *Seventh Report and Order*, 14 FCC Rcd at 8092-3, para. 32.

[25] *Ninth Report and Order*, 14 FCC Rcd at 20447, para. 25.

[26] *Qwest Corp. v. FCC*, 258 F.3d at 1197.

local calling capabilities. Therefore, support based on an analysis of rates would rely on an approach that the Commission has already determined to be faulty and inequitable.

In addition, the existing 135% cost based benchmark is sufficient for federal support. The 135% cost-based mechanism has already proven to provide reasonably comparable rates between urban and rural areas, thereby satisfying section 254.[27] The Commission has and needs only one clear mechanism that works. States set intrastate rates and therefore states have primary responsibility for ensuring that rural and urban rates are reasonably comparable. The Commission is obligated to provide adequate federal support and, as the Tenth Circuit notes, inducements for the states to fulfill their statutory responsibilities. If a state's rates are not reasonably comparable under the current mechanism, it would be due to state action or lack thereof, which could include any of the reasons given above as to why rates vary among states. The prospect of additional federal funding would eliminate rather than create inducements for states to create reasonably comparable rural and urban rates. If a state does not have reasonably comparable rates, California would support further federal actions such as have been suggested, including modifications to calling scopes or improvements in quality of service where state commissions have limited jurisdiction.

California also finds the supplemental rate mechanism to be unworkable, vague, and ill-defined. Such a mechanism would be an administrative burden for the Commission, states, and carriers, and would create the potential for endless litigation.

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[27] *GAO Report*.

Lastly, the supplemental rate mechanism would unnecessarily balloon the fund. In the *Ninth Report and Order*, the Commission attempted to ensure that the fund would be no larger than necessary in order to minimize burdens on carriers and consumers contributing to universal service mechanisms.[28] The Joint Board recognized that, in implementing a non-rural high-cost universal service mechanism, it must be mindful of two competing goals: "(1) supporting high-cost areas so that consumers there have affordable and reasonably comparable rates; and (2) maintaining a support system that does not, by its sheer size, overburden consumers across the nation."[29] In the *Rural Task Force Order*, the Commission has stated that "sufficiency" requires that the universal service support not be excessive, citing the United States Court of Appeals for the Fifth Circuit's caution that "excessive funding may itself violate the sufficiency requirements of the Act."[30] The Joint Board in the *Recommended Decision* also reaffirms that the statutory principle of sufficiency means that non-rural high-cost support should only be as large as necessary to achieve its statutory goal.[31] Correct fund size is essential to ensure that all consumers benefit from universal service.

[28] *Ninth Report and Order*, 14 FCC Rcd at 20464, para. 55.

[29] *Id*.

[30] *Rural Task Force Order*, 16 FCC Rcd at 11257, para. 27 (quoting *Alenco Communications, Inc. v. FCC*, 201 F.3d 608, 619 (5th Cir. 2000).

[31] *Recommended Decision*, FCC 02J-2, (Jt. Bd. rel. October 16, 2002), paras.15.

D. THE JOINT BOARD HAS DEFINED "SUFFICENT" MORE PRECISELY AND IN A WAY THAT CAN BE REASONBLY RELATED TO STATUTORY PRINCIPLES

The Tenth Circuit held that the Commission simply asserted without explanation that the mechanism it chose would be sufficient.[32] The Joint Board in the Recommended Decision proposes that, for purposes of non-rural high cost support, sufficiency should be principally defined as enough support to enable states to achieve reasonable comparability of rates. The Joint Board stated that sufficiency should be defined based on the relevant statutory goals under section 254(b). The principle purpose of the non-rural high-cost support mechanism is to provide enough federal support to enable states to achieve reasonable comparability of rural and urban rates, the principle found in section 254(b)(3).

We believe that the Joint Board has defined "sufficient" more precisely and in a way that can be reasonably related to the statutory principles, and has properly determined that the current cost-based funding mechanism will be sufficient in making rural and urban rates reasonably comparable.

III. CONCLUSION

While California is generally supportive of the Joint Board's Recommended Decision, California urges the Commission to carefully consider the effect of the supplemental rate mechanism on the overall size of the federal fund. A rate-based

[32] *Qwest Corp. v. FCC*, 258 F.3d 1191, 1201.

mechanism is contrary to the Commission's own rationale for having a cost-based support system. The existing 135% cost based benchmark is sufficient for federal

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support. California also finds that the supplemental rate mechanism would be unworkable, an administrative burden for the Commission, states, and carriers, and would create the potential for endless litigation.

Respectfully submitted,

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